

SURREBUTTAL TESTIMONY OF

MICHAEL L. SEAMAN-HUYNH

ON BEHALF OF

THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF

DOCKET NO. 2019-64-WS

IN RE: APPLICATION OF CUC, INCORPORATED FOR ADJUSTMENT

OF RATES AND CHARGES

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Michael Seaman-Huynh. My business address is 1401 Main Street, Suite 900, Columbia, South Carolina 29201. I am employed by the State of South Carolina as Deputy Director of Energy Operations at the Office of Regulatory Staff (“ORS”).

Q. DID YOU FILE DIRECT TESTIMONY AND EXHIBITS RELATED TO THIS PROCEEDING?

A. Yes. I filed direct testimony and six (6) exhibits with the Public Service Commission of South Carolina (“Commission”) on November 5, 2019. I subsequently filed revised direct testimony and six (6) exhibits with the Commission on November 6, 2019.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimonies filed by CUC, Inc.’s (“CUC” or “Company”) witnesses Mikell and Walsh on November 15, 2019. Specifically, I will focus on:

- ORS's adjustment to CUC's revenue requirement attributable to the excess revenue component of the 2017 Tax Cuts and Jobs Act ("TCJA"); and,
- ORS's recommended Operating Margin.

Q. PLEASE EXPLAIN ORS'S RECOMMENDATION REGARDING THE 2017 TAX CUTS AND JOBS ACT.

A. The change in the federal tax rate was extraordinary, beyond the control of CUC, and caused a material known and measurable change in the Company's federal income tax expense. As a result of the TCJA, the Company collected from its customers federal income taxes that the Company will never pay. ORS recommends the customers receive the full benefit of the change in federal income tax expense effective January 1, 2018. To provide the full benefit to customers, ORS calculated the revenue billed to CUC customers attributed to the change in federal income tax rate from the previously approved federal tax rate of 35% to 21%. Consistent with Commission Order No. 2018-308, ORS recommends \$78,110 be placed into a regulatory liability and amortized over three (3) years as discussed in my Direct Testimony.

In Docket No. 2017-381-A, ORS requested the Commission require the rates in effect as of January 1, 2018, be subject to refund so that customers received the benefits of the tax changes due to the TCJA. Further, the Commission required utilities to track and defer the effects resulting from the TCJA in a regulatory liability account in Order No. 2018-308. For water/wastewater utilities with operating revenues that are equal to or greater than \$250,000, the Commission specified the effects of the TCJA would be addressed in the next rate case or other proceeding. The Company's books and records contained no such regulatory liability account. As a result, ORS calculated the effects of

1 the TCJA and recommends an adjustment to return the full benefit of the reduction in
2 federal income tax rate to CUC customers.

3 **Q. PLEASE RESPOND TO COMPANY WITNESS WALSH'S ASSERTION THAT**
4 **THE CHANGE IN THE FEDERAL INCOME TAX RATE DID NOT RESULT IN**
5 **CUC EARNINGS IN EXCESS OF ITS AUTHORIZED OPERATING MARGIN?**

6 **A.** CUC witness Walsh interprets the term of "excess revenue" as "excess earnings."
7 This is incorrect and ORS's recommendation to provide CUC customers with the full
8 benefit of the TCJA does not depend upon or consider the Company's earnings. ORS's
9 reliance on the cost of service for the Company as approved in Commission Order No.
10 2014-1001 is appropriate to quantify the amount of revenue attributed to federal income
11 tax and included in the Commission-approved rates charged by CUC to its customers. In
12 summary, Order No. 2014-1001 approved a cost of service to allow the Company to
13 recover the 35% federal income tax rate. After the TCJA passed, the Company's federal
14 income tax rate was reduced to 21%; however, the Company continued to charge and
15 collect from its customers rates that contain a federal income tax rate of 35%. ORS
16 calculated this amount to be \$78,110 which is presented in my direct testimony Exhibit
17 MSH-4. The approved operating margin for the Company, as established in Order No.
18 2014-1001, represents a reasonable return the Company has the opportunity to earn if it
19 operates and is managed efficiently. The operating margin is not guaranteed, and the actual
20 operating margin earned by a utility may fluctuate over time. Efficient management
21 practices are the key to the Company realizing an operating margin allowed by the
22 Commission. The Company directly controls the timing and frequency of its next rate case

1 and therefore can determine when a re-evaluation of its operating margin is necessary
2 because it is not able to achieve its authorized operating margin.

3 The amount imbedded in CUC's rates to allow for full recovery of the 35% federal
4 income tax rate allows CUC the ability to meet its federal tax obligations. Therefore, the
5 amount paid by customers since January 1, 2018, attributed to the federal income tax
6 should not be considered by the Company as earnings. ORS recommends CUC customers
7 receive the full benefits of the TCJA as calculated by ORS.

8 **Q. IS THE ORS RECOMMENDED OPERATING MARGIN OF 12.51% FAIR AND**
9 **REASONABLE?**

10 **A.** Yes. ORS found CUC to be well-operated. The Company's Application detailed
11 no significant infrastructure or facility investments during the Test Year. In addition, the
12 Company's Application and testimony does not indicate that CUC faces additional risk or
13 seeks to attract additional capital. This indicates the Company is able, as a result of its
14 efficient management, to maintain high-quality, reliable water and sewer service at its
15 current operating margin. The increase in rates is driven primarily by an increase in
16 operating and maintenance expenses which is not reasonable justification for an increase
17 in operating margin. It appears the Company is requesting the customers pay more for the
18 same quality service. It is ORS's concern that if the operating margin is set too high for
19 the Company, the incentive to manage CUC's expenses in a cost-effective manner may
20 erode. ORS recommends an increase in rates and charges that is just and reasonable and
21 allows the Company an opportunity to earn a reasonable operating margin of 12.51%.

Q. DID COMPANY WITNESS MIKELL PROVIDE ANY JUSTIFICATION FOR WHY SHE BELIEVES AN INCREASE IN THE OPERATING MARGIN TO 15.18% IS REASONABLE?

A. No. Company witness Mikell stated “The level of increase the company has requested is also reasonable, so I believe our request for a 15.18% operating margin is fair and reasonable.”¹

Q. DID COMPANY WITNESS WALSH PROVIDE ANY JUSTIFICATION FOR WHY HE BELIEVES AN INCREASE IN THE OPERATING MARGIN TO 15.18% IS REASONABLE?

A. No. Company witness Walsh responded to ORS’s recommendation by providing his own calculations of average operating margins approved by the Commission from 2014 to present.

Q. PLEASE BRIEFLY SUMMARIZE THE DIFFERENCE BETWEEN ORS’S AND CUC’S COMMISSION-APPROVED OPERATING MARGIN AVERAGES.

A. Company witness Walsh identified four (4) additional cases regarding operating margins from 2014 to 2019 and recommended adding these additional dockets to the analysis of average operating margins. Witness Walsh further recommended removing two (2) cases from this list for having “abnormally low operating margins.”² Witness Walsh removed the T. J. Barnwell, Inc. (“T. J. Barnwell”) – Order No. 2016-49) and the other is a case that ORS included in its initial analysis - Synergy Utilities, Inc. (“Synergy”) – Order No. 2018-369. The awarded operating margins in these cases were 4.55% and 10.32%,

¹ Company witness Mikell’s Rebuttal Testimony, p 2.

² Company witness Walsh’s Rebuttal Testimony, p 8.

1 respectively. Witness Walsh removed these two (2) cases and reported average operating
2 margins of 14.52% from 2014 to 2019 and 14.30% from 2016 to 2019.³

3 Company witness Walsh provided an analysis of average operating margins that
4 exclude cases that sought return on rate base treatment. His resulting calculations for this
5 subset indicate operating margin averages of 14.95% from 2014 to 2019 and 14.40% from
6 2016 to 2019.⁴

7 **Q. PLEASE RESPOND TO COMPANY WITNESS WALSH'S ANALYSIS.**

8 **A.** In order to address Company witness Walsh's rebuttal, ORS reviewed and updated
9 its analysis to include the four (4) dockets identified by witness Walsh. I discuss this in
10 further detail below. The inclusion of these cases does not alter ORS's recommendation
11 regarding the appropriate operating margin for CUC.

12 That Company witness Walsh seeks to remove both the 2018 Synergy operating
13 margin of 10.32% and the 2016 T. J. Barnwell operating margin of 4.55% is arbitrary.
14 While the 4.55% operating margin may be an outlier, removing the 10.32% would be
15 unreasonable and unequitable because Company witness Walsh, in his analysis, includes
16 the high operating margins awarded to Palmetto Utilities, Inc. (*i.e.*, 17.98% in 2015) and
17 Palmetto Wastewater Reclamation, Inc. (*i.e.*, 17.07% in 2014). The inclusion by witness
18 Walsh of the highest operating margins and the elimination of the two (2) lowest operating
19 margins introduces bias that is favorable to his position.

20 **Q. PLEASE PROVIDE ORS'S UPDATED CALCULATION OF THE AVERAGE**
21 **OPERATING MARGIN WHICH INCLUDES THE FOUR ADDITIONAL**
22 **DOCKETS.**

³ Exhibit GW-3.

⁴ Exhibit GW-4.

A. In an effort to simplify the methodological differences between the original average operating margins put forward in my Direct Testimony and those in Company witness Walsh's Rebuttal Testimony, I offer the following Table 1 that reflects averages from 2014 to 2019 for only operating margin cases (*i.e.*, excluding those with applications seeking return on rate base treatment) that both include and exclude the 4.55% outlier for T. J. Barnwell in 2016.

Table 1: Averages of Commission-Approved Operating Margins 2014 – 2019⁵

	Scenario 1: Including 4.55%	Scenario 2: Excluding 4.55%
2014 - 2018 Average	13.52%	14.51%
2016 - 2018 Average	12.10%	13.61%
2014 - 2019 Average	13.58%	14.49%
2016 - 2019 Average	12.41%	13.72%

A number of observations can be derived from the results in this table. In Scenario 2, which excludes the 4.55% operating margin for T. J. Barnwell, but includes the Synergy 10.32% operating margin, the 2014 to 2019 average is nearly 0.5 percentage points lower than Company witness Walsh's calculation for the same time period. The 2016 to 2019 average in the same scenario is nearly 0.7 percentage points lower. It is important to note that these calculations still include the higher 17.07% and 17.98% operating margins from 2014 and 2015, respectively.

In addition, Scenario 1 provides the most complete picture of all Commission-approved operating margins in operating margin cases since 2014. With these calculations, the average from 2014 to 2019 is approximately 13.58% and from 2016 to 2019 is

⁵ Averages include all Commission-approved operating margins from 2014 to present for cases seeking operating margin treatment only. Scenario 1 includes the 2016 T. J. Barnwell, Inc. decision while Scenario 2 excludes this particular case for comparison purposes.

1 approximately 12.41%. These averages correspond much more closely to ORS's
2 recommended operating margin of 12.51%.

3 Further, in each scenario in Table 1 – as well as the scenarios put forward by
4 Company witness Walsh in Exhibit GW-3 and Exhibit GW-4 – the more recent time period
5 (*i.e.*, from 2016 forward) is lower relative to the period from 2014 forward regardless of
6 what cases may have been excluded. This indicates that the more recent trends of operating
7 margins from 2016 to present are lower than those from 2014 to present.

8 **Q. SHOULD THE TRENDING AVERAGE OF OPERATING MARGINS APPROVED**
9 **BY THE COMMISSION BE THE SOLE DETERMINING FACTOR IN**
10 **APPROVING AN APPROPRIATE OPERATING MARGIN?**

11 **A.** No. Benchmarking the operating margins between regulated water and sewer
12 companies is difficult. Absent clear guidance from the Commission, ORS asserts the
13 review of operating margin trends in South Carolina is a useful tool to gauge the
14 reasonableness of the Company's operating margin request; however, the trends should not
15 be given undeserved weight in determining an allowed operating margin. The averages
16 reflected in ORS and the Company's rebuttal testimony are comprised of utilities with a
17 variety of diverse financial and operational characteristics. The recommendation of
18 reasonable operating margins requires more than an observation of the authorized operating
19 margins of other water and sewer utilities. The Commission has discretion to consider
20 other items in establishing a reasonable operation margin such as: 1) the timing of approval
21 for the most recent operating margin; 2) specific Company characteristics such as capital
22 investments and possible revenue growth; and, 3) regulatory and other risks experienced
23 by the Company.

1 **Q. WILL YOU UPDATE YOUR TESTIMONY BASED ON INFORMATION THAT**
2 **BECOMES AVAILABLE?**

3 **A.** Yes. ORS fully reserves the right to revise its recommendations via supplemental
4 testimony should new information not previously provided by the Company, or other
5 sources, becomes available.

6 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

7 **A.** Yes, it does.